

## INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors  
Philadelphia Suburban Corporation:

We have audited the accompanying consolidated balance sheets and statements of capitalization of Philadelphia Suburban Corporation and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of income and comprehensive income, and cash flow for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Philadelphia Suburban Corporation and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with generally accepted accounting principles.

**KPMG LLP**

KPMG LLP

Philadelphia, Pennsylvania  
January 31, 2000

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except per share amounts)  
Years ended December 31, 1999, 1998 and 1997

	1999	1998	1997
Operating revenues	\$ 257,326	\$ 250,771	\$ 235,852
Costs and expenses:			
Operations and maintenance	98,758	100,139	96,571
Depreciation	30,612	27,189	25,581
Amortization	1,291	2,275	2,396
Taxes other than income taxes	21,833	21,930	21,345
Restructuring costs	3,787	-	-
	<u>156,281</u>	<u>151,533</u>	<u>145,893</u>
Operating income	101,045	99,238	89,959
Other expense (income):			
Interest expense, net	33,698	31,888	32,664
Dividends on preferred stock of subsidiary and minority interest	93	142	590
Allowance for funds used during construction	(1,995)	(1,245)	(937)
Merger transaction costs	6,334	-	-
Gain on sale of New Hampshire system	-	(6,680)	-
Income from continuing operations before income taxes	<u>62,915</u>	<u>75,133</u>	<u>57,642</u>
Provision for income taxes	<u>26,531</u>	<u>30,118</u>	<u>22,432</u>
Income from continuing operations	<u>36,384</u>	<u>45,015</u>	<u>35,210</u>
Discontinued operations:			
Loss from operations, net of tax	-	-	387
Loss on disposal of discontinued operations, net of tax	-	-	2,350
Net income	<u>36,384</u>	<u>45,015</u>	<u>32,473</u>
Dividends on preferred stock	109	195	195
Net income available to common stock	<u>\$ 36,275</u>	<u>\$ 44,820</u>	<u>\$ 32,278</u>
Net income	\$ 36,384	\$ 45,015	\$ 32,473
Other comprehensive income, net of tax	2,020	-	-
Comprehensive income	<u>\$ 38,404</u>	<u>\$ 45,015</u>	<u>\$ 32,473</u>
Basic net income (loss) per common share:			
Continuing operations	\$ 0.89	\$ 1.11	\$ 0.91
Discontinued operations	-	-	(0.07)
Total	<u>\$ 0.89</u>	<u>\$ 1.11</u>	<u>\$ 0.84</u>
Diluted net income (loss) per common share:			
Continuing operations	\$ 0.88	\$ 1.10	\$ 0.90
Discontinued operations	-	-	(0.07)
Total	<u>\$ 0.88</u>	<u>\$ 1.10</u>	<u>\$ 0.83</u>
Average common shares outstanding during the period:			
Basic	40,864	40,362	38,650
Diluted	<u>41,305</u>	<u>40,854</u>	<u>39,018</u>

See accompanying notes to consolidated financial statements.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except per share amounts)

December 31, 1999 and 1998

	1999	1998
Assets		
Property, plant and equipment, at cost	\$ 1,393,027	\$ 1,248,621
Less accumulated depreciation	257,663	232,427
Net property, plant and equipment	<u>1,135,364</u>	<u>1,016,194</u>
Current assets:		
Cash and cash equivalents	4,658	8,247
Accounts receivable and unbilled revenues, net	44,399	40,768
Inventory, materials and supplies	3,948	3,857
Prepayments and other current assets	6,520	7,026
Total current assets	<u>59,525</u>	<u>59,898</u>
Regulatory assets	58,287	57,697
Deferred charges and other assets, net	27,629	22,944
	<u>\$ 1,280,805</u>	<u>\$ 1,156,733</u>
Liabilities and Stockholders' Equity		
Stockholders' equity:		
6.05% Series B cumulative preferred stock	\$ 1,760	\$ 3,220
Common stock at \$.50 par value, authorized 100,000,000 shares, issued 41,627,644 and 41,235,603 in 1999 and 1998	20,814	20,617
Capital in excess of par value	251,440	244,457
Retained earnings	101,533	91,683
Minority interest	2,604	2,589
Treasury stock, 615,038 and 533,292 shares in 1999 and 1998	(11,270)	(9,478)
Accumulated other comprehensive income	2,020	-
Total stockholders' equity	<u>368,901</u>	<u>353,088</u>
Long-term debt, excluding current portion	413,752	374,374
Commitments	-	-
Current liabilities:		
Current portion of long-term debt	12,194	2,981
Loans payable	103,069	63,550
Accounts payable	24,286	25,248
Accrued interest	8,994	8,406
Accrued taxes	12,689	14,382
Other accrued liabilities	22,581	20,462
Total current liabilities	<u>183,813</u>	<u>135,029</u>
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	136,528	126,809
Customers' advances for construction	59,494	57,781
Other	8,434	8,735
Total deferred credits and other liabilities	<u>204,456</u>	<u>193,325</u>
Contributions in aid of construction	109,883	100,917
	<u>\$ 1,280,805</u>	<u>\$ 1,156,733</u>

See accompanying notes to consolidated financial statements.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CAPITALIZATION  
(In thousands of dollars, except per share amounts)  
December 31, 1999 and 1998

	1999	1998
Stockholders' equity:		
6.05% Series B cumulative preferred stock	\$ 1,760	\$ 3,220
Common stock, \$.50 par value	20,814	20,617
Capital in excess of par value	251,440	244,457
Retained earnings	101,533	91,683
Minority interest	2,604	2,589
Treasury stock	(11,270)	(9,478)
Accumulated other comprehensive income	2,020	-
Total stockholders' equity	<u>368,901</u>	<u>353,088</u>
Long-term debt:		
First Mortgage Bonds secured by utility plant:		
Interest Rate Range		
0.00% to 2.49%	858	949
2.50% to 4.99%	824	-
5.00% to 5.49%	2,200	-
5.50% to 5.99%	31,545	21,945
6.00% to 6.49%	127,210	87,210
6.50% to 6.99%	55,200	55,200
7.00% to 7.49%	38,000	40,001
7.50% to 7.99%	23,000	23,000
8.00% to 8.49%	16,500	16,500
8.50% to 8.99%	9,003	9,011
9.00% to 9.49%	53,695	53,776
9.50% to 9.99%	51,220	51,820
10.00% to 10.55%	6,000	6,000
Total First Mortgage Bonds	<u>415,255</u>	<u>365,412</u>
Notes payable to banks under revolving credit agreements, due June 2000	9,200	10,400
Installment note payable, 9%, due in equal annual payments through 2013	1,491	1,543
	<u>425,946</u>	<u>377,355</u>
Current portion of long-term debt	12,194	2,981
Long-term debt, excluding current portion	<u>413,752</u>	<u>374,374</u>
Total capitalization	<u>\$ 782,653</u>	<u>\$ 727,462</u>

See accompanying notes to consolidated financial statements.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
CONSOLIDATED CASH FLOW STATEMENTS

(In thousands of dollars)

Years ended December 31, 1999, 1998 and 1997

	1999	1998	1997
Cash flows from operating activities:			
Net income	\$ 36,384	\$ 45,015	\$ 32,473
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	31,903	29,464	27,977
Deferred income taxes	6,342	9,957	5,883
Gain on sale of New Hampshire system	-	(6,680)	-
Net increase in receivables, inventory and prepayments	(3,073)	(3,623)	(933)
Net increase in payables, accrued interest and other accrued liabilities	444	11,216	4,801
Other	1,600	(2,476)	(1,483)
Net cash flows from discontinued operations	503	1,489	184
Net loss from discontinued operations	-	-	2,350
Net cash flows from operating activities	<u>74,103</u>	<u>84,362</u>	<u>71,252</u>
Cash flows from investing activities:			
Property, plant and equipment additions, including allowance for funds used during construction of \$1,995, \$1,245 and \$937	(96,383)	(87,973)	(67,378)
Acquisitions of water and wastewater systems	(39,164)	(24,498)	(1,226)
Proceeds from sale of New Hampshire system	-	33,728	-
Other	(5,069)	(899)	125
Net cash flows used in investing activities	<u>(140,616)</u>	<u>(79,642)</u>	<u>(68,479)</u>
Cash flows from financing activities:			
Customers' advances and contributions in aid of construction	5,345	3,902	8,069
Repayments of customers' advances	(4,077)	(3,062)	(4,215)
Net proceeds (repayments) of short-term debt	39,519	(4,615)	6,316
Proceeds from long-term debt	54,412	33,395	29,631
Repayments of long-term debt	(6,733)	(24,918)	(25,997)
Redemption of preferred stock	(1,460)	(4,214)	(1,438)
Proceeds from issuing common stock	7,061	32,589	14,258
Repurchase of common stock	(1,773)	(3,334)	(2,287)
Dividends paid on preferred stock	(117)	(195)	(195)
Dividends paid on common stock	(29,217)	(29,349)	(26,752)
Other	(36)	(46)	(82)
Net cash flows from (used in) financing activities	<u>62,924</u>	<u>153</u>	<u>(2,692)</u>
Net increase (decrease) in cash and cash equivalents	(3,589)	4,873	81
Cash and cash equivalents at beginning of year	8,247	3,374	3,293
Cash and cash equivalents at end of year	<u>\$ 4,658</u>	<u>\$ 8,247</u>	<u>\$ 3,374</u>

See Summary of Significant Accounting Policies-Customers' Advances for Construction, Merger with Consumers Water Company, Acquisitions and Water Sale Agreements, Income Taxes and Employee Stock and Incentive Plans footnotes for description of non-cash activities.

See accompanying notes to consolidated financial statements.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (In thousands of dollars, except per share amounts)

#### Summary of Significant Accounting Policies

*Basis of Presentation* - On March 10, 1999, Philadelphia Suburban Corporation (the "Company") completed a merger (the "Merger") with Consumers Water Company ("CWC"). On the date of the Merger, the Company issued 13,014,015 shares of Common Stock in exchange for all of the outstanding shares of CWC and CWC became a wholly-owned subsidiary of the Company. The Merger has been accounted for as a pooling-of-interests under Accounting Principles Board Opinion No. 16. Accordingly, the Company's consolidated financial statements and footnotes presented in this report have been restated to include the accounts and results of CWC as if the Merger had been completed as of the beginning of the earliest period presented.

*Nature of Operations* - The business of the Company is conducted primarily through its wholly-owned subsidiary Philadelphia Suburban Water Company ("PSW") and the seven operating companies of CWC. PSW is a regulated public utility which supplies water to approximately 319,000 customers. The service territory of PSW covers an area located west and north of the City of Philadelphia. CWC owns 100% of the voting stock of four water companies and at least 96% of the voting stock of three water companies. These water companies are regulated utilities providing water and wastewater service in 27 operating divisions to approximately 230,000 customers in Pennsylvania, Ohio, Illinois, New Jersey and Maine. In addition, the Company provides water service to approximately 8,500 customers through operating and maintenance contracts in Pennsylvania, Illinois and Maine.

The customers of PSW and CWC's operating subsidiaries are residential, commercial and industrial in nature. The regulated public utilities are subject to regulation by the public utility commissions of the states in which they operate. The respective public utility commissions have jurisdiction with respect to rates, service, accounting procedures, issuance of securities, acquisitions and other matters.

*Consolidation* - The consolidated financial statements include the accounts of the Company and its subsidiaries as of December 31, 1999. All material intercompany accounts and transactions have been eliminated.

*Recognition of Revenues* - Revenues include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period. Non-utility revenues are recognized when services are performed.

*Property, Plant and Equipment and Depreciation* - Property, plant and equipment consist primarily of utility plant. The cost of additions includes contracted cost, direct labor and fringe benefits, materials, overheads and, for certain utility plant, allowance for funds used during construction. Water systems acquired are recorded at estimated original cost of utility plant when first devoted to utility service and the applicable depreciation is recorded to accumulated depreciation. The difference between the estimated original cost, less applicable accumulated depreciation, and the purchase price is recorded as an acquisition adjustment within utility plant. At December 31, 1999, utility plant includes a net credit acquisition adjustment of \$8,403, which is being amortized over 20 to 40 years. Consistent with the Company's rate settlements, \$575 was amortized during 1999, \$565 was amortized during 1998 and \$534 was amortized during 1997.

Utility expenditures for maintenance and repairs, including minor renewals and betterments, are charged to operating expenses in accordance with the system of accounts prescribed by the public utility commissions of the states in which the company operates. The cost of new units of property and betterments are capitalized. When units of utility property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The straight-line remaining life method is used to compute depreciation on utility plant. Generally, the straight-line method is used with respect to transportation and mechanical equipment, office equipment and laboratory equipment.

In accordance with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed Of", the long-lived assets of the Company, which consist primarily of Utility Plant in Service and regulatory assets, have been reviewed for impairment. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of these assets.

*Allowance for Funds Used During Construction* - The allowance for funds used during construction ("AFUDC") is a non-cash credit which represents the estimated cost of funds used to finance the construction of utility plant. In general, AFUDC is applied to construction projects requiring more than one month to complete. No AFUDC is applied to projects funded by customer advances for construction or contributions in aid of construction. AFUDC includes the net cost of borrowed funds and a rate of return on other funds when used, and is recovered through water rates as the utility plant is depreciated. The amount of AFUDC related to equity funds was \$57 in 1999. There was no AFUDC related to equity funds in 1998 or 1997.

*Cash Equivalents* - The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

*Deferred Charges and Other Assets* - Deferred charges and other assets consist of financing expenses, rate case expenses, other costs and marketable securities.

Deferred bond issuance expenses are amortized by the straight-line method over the life of the related issues. Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and amortized over the life of the long-term debt used to fund the redemption.

Expenses associated with filing for rate increases are deferred and amortized over periods that generally range from one to three years. Other costs, for which the Company has received or expects to receive prospective rate recovery, are deferred and amortized over the period of rate recovery.

Marketable securities are considered "available-for-sale" and accordingly, are carried on the balance sheet at fair market value. Unrecognized gains are included in other comprehensive income.

*Income Taxes* - The Company accounts for certain income and expense items in different time periods for financial reporting than for tax reporting purposes. Deferred income taxes are provided on the temporary differences between the tax basis of the assets and liabilities and the amounts at which they are carried in the consolidated financial statements. The income tax effect of temporary differences not allowed currently in rates is recorded as deferred taxes with an offsetting regulatory asset or liability. These deferred income taxes are based on the enacted tax rates expected to be in effect when such temporary differences are projected to reverse.

*Customers' Advances for Construction* - Water mains or, in some instances, cash advances to reimburse the Company its costs to construct water mains, are contributed to the Company by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Customers' Advances for Construction. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to and

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

take service from the main. After all refunds are made, any remaining balance is transferred to Contributions in Aid of Construction. Non-cash property, in the form of water mains, has been received, generally from developers, as advances or contributions of \$10,069, \$8,774 and \$6,080 in 1999, 1998 and 1997.

*Contributions in Aid of Construction* - Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that become non-refundable.

*Inventories, Materials and Supplies* - Inventories are stated at cost, not in excess of market value. Cost is determined using the first-in, first-out method and the average cost method.

*Stock-Based Compensation* - The Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation", electing the provision of the statement allowing it to continue its practice of not recognizing compensation expense related to granting of stock options to the extent that the option price of the underlying stock was equal to, or greater than, the market price on the date of option grant. Disclosure of the impact on the results of operations, had the Company elected to recognize compensation expense, is provided in the Employee Stock and Incentive Plans footnote as required by the Statement.

*Use of Estimates in Preparation of Consolidated Financial Statements* - The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Reclassifications* - Certain prior year amounts have been reclassified to conform with current year's presentation.

### Merger with Consumers Water Company

On March 10, 1999, the Company completed a merger ("the Merger") with CWC. Pursuant to the merger agreement, the Company issued 13,014,015 shares of Common Stock in exchange for all of the outstanding stock of CWC. CWC common shareholders received 1.432 shares of the Company's Common Stock for each CWC common share and CWC preferred shareholders received 5.649 shares of the Company's Common Stock for each CWC preferred share. As a result of the Merger, CWC became a wholly-owned subsidiary of the Company. CWC's seven water companies serve approximately 230,000 customers in service territories covering parts of Pennsylvania, Ohio, Illinois, New Jersey and Maine. The results of operations previously reported by PSC and CWC are as follows (certain amounts previously reported have been reclassified to conform to the current presentation):

	Years Ended December 31,	
	1998	1997
Operating Revenues		
PSC	\$ 150,977	\$ 136,171
CWC	98,469	98,339
Combined	<u>\$ 249,446</u>	<u>\$ 234,510</u>
Net income		
PSC	\$ 28,819	\$ 23,188
CWC	16,251	9,339
Combined	<u>\$ 45,070</u>	<u>\$ 32,527</u>



## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

During 1999, the Company recorded a charge of \$6,334 (\$6,134, after tax benefits of \$200) for merger transaction costs consisting primarily of fees for investment bankers, attorneys, accountants and other administrative charges. In addition, the Company recorded a restructuring reserve of \$3,787 (\$2,462, after tax benefits of \$1,325) in 1999 that includes severance of \$2,940 and exit costs associated with the closing of CWC's corporate office. Through December 31, 1999, the initial reserve has been reduced principally by cash payments of \$3,434 and the balance is anticipated to be paid during the second quarter of 2000. The merger transaction costs have been reported in Other expenses and the restructuring costs have been reported as Costs and expenses in the Consolidated Statements of Income and Comprehensive Income.

#### Acquisitions and Water Sale Agreements

During 1999, exclusive of the Merger, 16 acquisitions or other growth ventures were completed in the five states in which the Company operates. These transactions have added 17,250 customers to the Company's customer base. The largest of these transactions was the acquisition of the water utility assets of Bensalem Township in December 1999, which has added 14,945 customers. The total purchase price for the systems acquired in 1999 was \$39,164 in cash. The increase in annual revenues resulting from the acquired systems approximate \$4,900 (unaudited) and operating revenues included in the consolidated financial statements during the period owned by the Company were \$559.

During 1998, five water system acquisitions were completed and two long-term water sale agreements were obtained in Pennsylvania and New Jersey. These transactions have added 9,007 customers to the Company's customer base. The total purchase price of \$25,380 for the five water systems acquired in 1998 was \$24,498 in cash and the issuance of 42,000 shares of the Company's common stock. Operating revenues included in the consolidated financial statements related to the systems acquired and new water sale agreements obtained in 1998 were \$4,685 in 1999 and \$4,627 in 1998.

During 1997, one wastewater and three water system acquisitions were completed by PSW. The total purchase price for the systems acquired in 1997 was \$1,226. Operating revenues included in the consolidated financial statements related to the systems acquired in 1997 were \$363 in 1999, \$367 in 1998 and \$175 in 1997.

#### Disposition

In April 1998, CWC's New Hampshire subsidiary sold its utility assets to the Town of Hudson under the New Hampshire condemnation statute for \$33,728, net of certain closing costs. The sale generated a gain of \$6,680 (\$3,903 net of taxes, or \$0.10 per share), and was recorded in the second quarter of 1998. This system had approximately 8,200 customers and operating revenues of \$1,600 in 1998 prior to the sale and \$6,500 in 1997.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

### Property, Plant and Equipment

	December 31,	
	1999	1998
Utility plant and equipment	\$ 1,340,361	\$ 1,213,330
Utility construction work in progress	49,271	31,327
Non-utility plant and equipment	3,395	3,964
Total property, plant and equipment	<u>\$ 1,393,027</u>	<u>\$ 1,248,621</u>

Depreciation is computed based on estimated useful lives of 2 to 110 years for utility plant and 3 to 10 years for both utility transportation and mechanical equipment and all non-utility plant, office equipment and laboratory equipment.

### Accounts Receivable

	December 31,	
	1999	1998
Billed water revenue	\$ 23,953	\$ 21,666
Unbilled water revenue	20,747	19,398
Other	1,007	1,140
	<u>45,707</u>	<u>42,204</u>
Less allowance for doubtful accounts	1,308	1,436
Net accounts receivable	<u>\$ 44,399</u>	<u>\$ 40,768</u>

The Company's customers are located in the following states: 66% in Pennsylvania, 14% in Ohio, 11% in Illinois, 6% in New Jersey and 3% in Maine. PSW's customers are located in southeastern Pennsylvania and accounted for 58% of the customers served. No single customer accounted for more than one percent of the Company's operating revenues.

### Regulatory Asset

The regulatory asset represents costs that are excluded from the Company's rate base but are expected to be fully recovered in future rates. The two components of this asset are deferred income taxes and postretirement benefits other than pensions. Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to certain differences between tax and book depreciation expense, are recognized in the rate setting process on a cash or flow-through basis and will be recovered as they reverse. The portion of the asset related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates.

	December 31,	
	1999	1998
Income taxes	\$ 56,467	\$ 55,437
Postretirement benefits other than pensions	1,820	2,260
	<u>\$ 58,287</u>	<u>\$ 57,697</u>

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

### Income Taxes

Total income tax expense is allocated as follows:

	Years Ended December 31,		
	1999	1998	1997
Income from continuing operations	\$ 26,531	\$ 30,118	\$ 22,432
Common stockholders' equity related to stock option activity which reduces taxable income	(205)	(402)	(401)
Discontinued operations	-	-	(1,455)
	<u>\$ 26,326</u>	<u>\$ 29,716</u>	<u>\$ 20,576</u>

Income tax expense attributable to income from continuing operations consists of:

	Years Ended December 31,		
	1999	1998	1997
Current:			
Federal	\$ 15,233	\$ 14,837	\$ 13,480
State	3,695	5,583	3,087
	<u>18,928</u>	<u>20,420</u>	<u>16,567</u>
Deferred:			
Federal	6,862	8,453	5,086
State	741	1,245	779
	<u>7,603</u>	<u>9,698</u>	<u>5,865</u>
Total tax expense	<u>\$ 26,531</u>	<u>\$ 30,118</u>	<u>\$ 22,432</u>

The significant components of deferred income tax expense are as follows:

	Years Ended December 31,		
	1999	1998	1997
Excess of tax over financial statement depreciation	\$ 5,377	\$ 10,325	\$ 6,488
Amortization of deferred investment tax credits	(216)	(660)	(290)
Current year investment tax credits deferred	118	20	35
Differences in basis of fixed assets due to variations in tax and book accounting methods that reverse through depreciation	2,123	1,762	786
Pension, deferred compensation and other postretirement benefits	(58)	(752)	(184)
Customers' advances for construction, net	806	321	773
Other, net	(547)	(1,318)	(1,743)
Total deferred income tax expense	<u>\$ 7,603</u>	<u>\$ 9,698</u>	<u>\$ 5,865</u>

The statutory Federal tax rate is 35% and the state corporate net income tax rates range from 7.18% to 11.50% for all years presented.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The reasons for the differences between amounts computed by applying the statutory Federal income tax rate to income from continuing operations before Federal tax and the actual Federal tax expense are as follows:

	Years Ended December 31,		
	1999	1998	1997
Computed Federal tax expense at statutory rate	\$ 20,390	\$ 23,839	\$ 18,753
Increase in tax expense for depreciation expense to be recovered in future rates	387	1,091	162
Merger transaction costs	2,017	-	-
Charitable contribution	(479)	-	-
Gain on sale of land	83	-	-
Amortization of deferred investment tax credits	(279)	(658)	(292)
Prior year rate reductions	(313)	(655)	(147)
Preferred stock dividend	32	147	272
Difference in statutory rate	-	(240)	(186)
Other, net	257	(234)	4
Actual Federal tax expense	<u>\$ 22,095</u>	<u>\$ 23,290</u>	<u>\$ 18,566</u>

The tax effects of temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	December 31,	
	1999	1998
Deferred tax assets:		
Customers' advances for construction	\$ 19,896	\$ 21,527
Costs expensed for book not deducted for tax, principally accrued expenses and bad debt reserves	4,952	3,244
Alternative minimum tax	1,464	1,464
Other	292	187
Total gross deferred tax assets	<u>26,604</u>	<u>26,422</u>
Deferred tax liabilities:		
Utility plant, principally due to depreciation and differences in the basis of fixed assets due to variation in tax and book accounting	129,083	122,922
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	24,793	22,236
Deferred investment tax credit	7,823	8,073
Unrealized gain on marketable securities	1,433	-
Total gross deferred tax liabilities	<u>163,132</u>	<u>153,231</u>
Net deferred tax liability	<u>\$ 136,528</u>	<u>\$ 126,809</u>

The Company made income tax payments of \$20,313, \$15,746 and \$14,131 in 1999, 1998 and 1997, respectively. The Company's Federal income tax returns for all years through 1995 have been closed.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

#### Commitments

PSW maintains agreements with the Chester Water Authority and the Bucks County Water and Sewer Authority for the purchase of water to supplement its water supply, particularly during periods of peak demand. The agreements stipulate purchases of minimum quantities of water to the year 2017. As a result of the December 1999 Bensalem acquisition, the estimated annual commitments related to such purchases will increase to approximately \$5,338 through 2004. PSW purchased approximately \$3,172, \$3,012 and \$2,978 of water under these agreements during the years ended December 31, 1999, 1998 and 1997, respectively.

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. During the next five years, \$2,556 of future minimum lease payments are due: \$1,129 in 2000, \$853 in 2001, \$378 in 2002 and \$186 in 2003 and \$10 in 2004. PSW leases parcels of land on which its Media treatment plant and other facilities are situated and adjacent parcels that are used for watershed protection. The operating lease is noncancelable, expires in 2045 and contains certain renewal provisions. The lease is subject to an adjustment every five years based on changes in the Consumer Price Index. During each of the next five years, \$292 of lease payments for land, subject to the aforesaid adjustment, are due.

Rent expense was \$1,894, \$2,270 and \$2,166 for the years ended December 31, 1999, 1998 and 1997, respectively.

#### Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provides a summary of long-term debt and loans outstanding as of December 31, 1999 and 1998. The supplemental indentures with respect to certain issues of the First Mortgage Bonds restrict the ability of PSW and CWC to declare dividends, in cash or property, or repurchase or otherwise acquire PSW's and CWC's stock. As of December 31, 1999, approximately \$146,000 of PSW's and \$59,000 of CWC's retained earnings were free of these restrictions. Certain supplemental indentures also prohibit PSW and CWC from making loans to or purchasing the stock of the Company.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

Annual sinking fund payments are required for certain issues of First Mortgage Bonds by the supplemental indentures. Excluding amounts due under the revolving credit agreements, the Company's future sinking fund payments and debt maturities are as follows:

Interest Rate Range	2000	2001	2002	2003	2004	Thereafter
0.00% to 2.49%	\$ 84	\$ 70	\$ 83	\$ 84	\$ 75	\$ 462
2.50% to 4.99%	10	10	10	10	10	774
5.00% to 5.49%	-	-	-	-	-	2,200
5.50% to 5.99%	400	400	400	10,000	10,000	10,345
6.00% to 6.49%	-	-	10,000	-	15,000	102,210
6.50% to 6.99%	-	-	-	10,400	400	44,400
7.00% to 7.49%	2,000	2,000	2,000	12,000	12,000	8,000
7.50% to 7.99%	-	-	-	-	-	23,000
8.00% to 8.49%	-	-	-	-	-	16,500
8.50% to 8.99%	3	-	-	-	-	9,000
9.00% to 9.49%	137	142	548	554	561	53,244
9.50% to 9.99%	360	1,155	1,154	1,155	1,154	46,242
10.00% to 10.55%	-	-	-	-	-	6,000
Total	\$ 2,994	\$ 3,777	\$ 14,195	\$ 34,203	\$ 39,200	\$ 322,377

In December 1999, PSW established a five-year \$300,000 medium-term note program providing for the issuance of long-term debt with maturities ranging between one and 35 years at fixed rates of interest, as determined at the time of issuance. This program replaced a similar program that expired in June 1999. The notes issued under this program are secured by the Thirty-Third Supplement to the trust indenture relating to PSW's First Mortgage Bonds. During 1999, First Mortgage Bond issuances through these programs were as follows: \$10,000 in January 1999, 5.85% Series due 2004; and \$15,000 in April 1999, 6.00% Series due 2004. In January 1998, PSW issued First Mortgage Bonds through the program as follows: \$10,000 6.14% Series due 2008 and \$10,000 5.8% Series due 2003. In January 2000, PSW issued First Mortgage Bonds through the program of \$15,000 7.40% Series due 2005. The proceeds from these issuances were used to fund acquisitions, to reduce the balance of PSW's revolving credit facility and for PSW's ongoing capital program.

In June 1999, CWC's Maine subsidiary issued a First Mortgage Bond of \$2,200 5.05% Series due 2024. In August 1999, CWC's Maine subsidiary issued a First Mortgage Bond of \$824 2.68% Series due 2019. Proceeds from these issues were used to reduce the balance of its short-term debt. In October 1999, PSW issued \$25,000 in First Mortgage Bonds 6.00% Series due 2029 as security for an equal amount of Bonds issued by the Delaware County Industrial Development Authority. The proceeds from these bonds are restricted to funding the costs of certain capital projects.

In April 1998, CWC's New Hampshire subsidiary sold its utility assets and used the proceeds to retire \$6,000 of First Mortgage Bonds 8.00% Series due 2004, \$2,000 of First Mortgage Bonds 10.55% Series due 2007, \$2,000 of First Mortgage Bonds 10.54% Series due 2009 and \$2,000 of First Mortgage Bonds 9.96% Series due 2009. During 1998, CWC's Ohio subsidiary retired \$1,215 of First Mortgage Bonds 8.75% Series due 2003.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

In December 1999, PSW replaced its expiring revolving credit facility with a new \$50,000 revolving credit agreement due December 2000 with three banks. As of December 31, 1999 and 1998, funds borrowed under the PSW revolving credit agreements of \$50,000 and \$38,935, respectively, have been classified as loans payable. CWC has a \$20,000 revolving credit facility, which expires in June 2000, and has been classified as current portion of long-term debt. Prior to their expiration in June 1999, CWC had other revolving credit facilities available. Interest under these facilities is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the banks. These agreements restrict the total amount of short-term borrowings of PSW and CWC. A commitment fee ranging from 1/4 to 1/10 of 1% is charged on the unused portion of the revolving credit agreements. The average cost of borrowing under these facilities was 5.6% and 6.0%, and the average borrowing was \$47,037 and \$40,701, during 1999 and 1998, respectively. The maximum amount outstanding at the end of any one month was \$59,600 in 1999 and \$52,875 in 1998.

At December 31, 1999 and 1998, the Company had combined short-term lines of credit of \$116,000 and \$105,300, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. The average borrowing under the lines was \$36,809 and \$21,684 during 1999 and 1998, respectively. The maximum amount outstanding at the end of any one month was \$53,069 in 1999 and \$27,990 in 1998. Interest under the lines is based at the Company's option, depending on the line, on the prime rate, an adjusted Euro-Rate, an adjusted federal funds rate or at rates offered by the banks. The average cost of borrowings under all lines during 1999 and 1998 was 6.0% and 6.5%, respectively.

The total amount of interest paid on all borrowings, net of amounts capitalized, was \$31,036, \$30,711 and \$31,970 in 1999, 1998 and 1997, respectively. The pro forma weighted cost of long-term debt at both December 31, 1999 and 1998 was 7.4%.

### Preferred Stock of Subsidiaries

The Company's subsidiaries have the following preferred stock (\$100 par value) as of December 31, 1999:

	Cumulative Dividend Rate	Current Call Price Per Share	Shares Authorized	Shares Outstanding
Consumers Pennsylvania - Shenango Valley Division	5.00%	\$ 110	10,000	9,925
Consumers Illinois Water Company	5.50%	107	5,000	3,575
Consumers Maine Water Company	5.00%	105	4,000	2,739
PSW	-	None	1,000,000	-

PSW is authorized to issue preferred stock with mandatory redemption requirements, with stated par value, in one or more series. In 1991, PSW issued 100,000 shares of 8.66% Series 1 Cumulative Preferred Stock, at par value of \$100 per share in a private placement. The remaining shares of this issue were called by PSW and retired in 1998.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

#### Fair Value of Financial Instruments

The carrying amount of current assets and liabilities that are considered financial instruments approximates their fair value as of the dates presented. The carrying amount and estimated fair value of the Company's long-term debt as of December 31, 1999 is \$425,946 and \$415,653, respectively. The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration.

The Company's customers' advances for construction and related tax deposits have a carrying value of \$59,494 at December 31, 1999. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2020 and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

#### Stockholders' Equity

At December 31, 1999, the Company had 1,770,819 shares of Series Preferred Stock with a \$1.00 par value authorized, of which 100,000 shares are designated as Series A Preferred Stock. During 1996, the Company designated 32,200 shares as Series B Preferred Stock, \$1.00 par value. The Series A Preferred Stock, as well as the undesignated shares of Series Preferred Stock, remains unissued. In 1996, the Company issued all of the 6.05% Series B Preferred Stock in connection with an acquisition. The Series B Preferred Stock is recorded on the balance sheet at its liquidation value of \$100 per share. Dividends on the Series B Preferred Stock are cumulative and payable quarterly. PSC may not pay dividends on common stock unless provision has been made for payment of the preferred dividends. Under the provisions of this issue, the holders may redeem the shares, in whole or in part, at the liquidation value beginning December 1, 1998 and the Company may redeem up to 20% of this issue each year beginning December 1, 2001 and, at the holders' option, this redemption may be made in cash or through the issuance of debt with a five year maturity at an interest rate of 6.05%. As of December 31, 1999, all dividends have been provided for. In January 1999, 14,600 shares were redeemed in cash at the liquidation value of \$100 per share.

At December 31, 1999, the Company had 100,000,000 shares of common stock authorized; par value \$0.50. Shares outstanding at December 31, 1999, 1998 and 1997 were 41,012,606, 40,702,311, and 39,111,642 respectively. Treasury shares held at December 31, 1999, 1998 and 1997 were 615,038, 533,292, and 376,510 respectively.



# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The following table summarizes the activity of common stockholders' equity:

	Common stock	Treasury stock	Capital in excess of par value	Retained earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 1996	\$ 16,013	\$ (3,647)	\$ 200,629	\$ 70,869	\$ -	\$ 283,864
Net income	-	-	-	32,278	-	32,278
Dividends	-	-	-	(26,877)	-	(26,877)
Stock split	3,276	-	(3,276)	-	-	-
Sale of stock	346	506	11,029	-	-	11,881
Repurchase of stock	-	(2,829)	-	-	-	(2,829)
Equity Compensation Plan	1	-	50	-	-	51
Exercise of stock options	108	-	2,750	-	-	2,858
Balance at December 31, 1997	19,744	(5,970)	211,182	76,270	-	301,226
Net income	-	-	-	44,820	-	44,820
Dividends	-	-	-	(29,407)	-	(29,407)
Sale of stock	761	293	30,495	-	-	31,549
Repurchase of stock	-	(3,801)	-	-	-	(3,801)
Equity Compensation Plan	12	-	491	-	-	503
Exercise of stock options	100	-	2,289	-	-	2,389
Balance at December 31, 1998	20,617	(9,478)	244,457	91,683	-	347,279
Net income	-	-	-	36,275	-	36,275
Other comprehensive income	-	-	-	-	2,020	2,020
Dividends	-	-	-	(26,425)	-	(26,425)
Sale of stock	114	354	4,807	-	-	5,275
Repurchase of stock	-	(2,146)	-	-	-	(2,146)
Equity Compensation Plan	2	-	98	-	-	100
Exercise of stock options	81	-	2,078	-	-	2,159
Balance at December 31, 1999	\$ 20,814	\$ (11,270)	\$ 251,440	\$ 101,533	\$ 2,020	\$ 364,537

The Company reports comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income." Accordingly, the Company's accumulated other comprehensive income for unrealized gains on securities is reported in the Stockholders' Equity section of the Consolidated Balance Sheets and the related other comprehensive income is reported in the Consolidated Statements of Income and Comprehensive Income.

In December 1999, the Company filed a shelf registration statement with the Securities and Exchange Commission for the offering and sale of up to approximately \$42,000 of common stock and \$50,000 of preferred stock, all of which was unused. The Company expects to offer from time to time, these shares for acquisitions. The precise amount and timing of the application of such proceeds will depend upon our funding requirements and the availability and cost of other funds.

In February 1998, the Company issued 1,250,000 shares of common stock through a public offering, providing net proceeds of \$25,840 which were used to repay short term debt and to make a \$19,000 equity contribution to PSW. PSW used the contribution from the Company to reduce the balance of its revolving credit loan.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

In December 1997, the Company adopted a Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") that replaced the Customer Stock Purchase Plan and the Dividend Reinvestment and Optional Stock Purchase Plan. Under the Plan, reinvested dividends continue to be used to purchase original issue shares of common stock at a five percent discount from the current market value. Under the direct stock purchase program, shares are purchased by investors throughout the year, instead of during limited subscription periods, at market price and the shares are purchased by the Company's transfer agent in the open-market at least weekly. The plans that were replaced sold original issue shares exclusively. During 1999 and 1998, under the dividend reinvestment portion of the Plan, 229,476 and 204,316 original issue shares of common stock were sold providing the Company with proceeds of \$5,044 and \$4,197, respectively. During 1997, under the former plans, 792,717 original issue shares of common stock were sold providing the Company with \$11,242 of additional capital, after expenses.

The Board of Directors has authorized the Company to purchase its common stock, from time to time, in the open market or through privately negotiated transactions. During 1999, 1998 and 1997, 81,400, 151,406, and 152,000 shares have been purchased at a net cost of \$1,771, \$3,333, and \$2,284, respectively. As of December 31, 1999, 395,339 shares remain available for purchase by the Company.

### Net Income per Common Share and Equity per Common Share

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock options is included in the computation of Diluted net income per share. The following table summarizes the shares, in thousands, used in computing Basic and Diluted net income per share:

	Years ended December 31,		
	1999	1998	1997
Average common shares outstanding during the period for Basic computation	40,864	40,362	38,650
Dilutive effect of employee stock options	441	492	368
Average common shares outstanding during the period for Diluted computation	41,305	40,854	39,018

Equity per common share was \$8.89 and \$8.53 at December 31, 1999 and 1998, respectively. These amounts were computed by dividing common stockholders' equity by the number of shares of common stock outstanding at the end of each year.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

#### Shareholder Rights Plan

The Company has a Shareholder Rights Plan designed to protect the Company's shareholders in the event of an unsolicited unfair offer to acquire the Company. Each outstanding common share is entitled to one Right which is evidenced by the common share certificate. In the event that any person acquires 20% or more of the outstanding common shares or commences a tender or exchange offer which, if consummated, would result in a person or corporation owning at least 20% of the outstanding common shares of the Company, the Rights will begin to trade independently from the common shares and, if certain circumstances occur, including the acquisition by a person of 20% or more of the outstanding common shares, each Right would then entitle its holder to purchase a number of common shares of the Company at a substantial discount. If the Company is involved in a merger or other business combination at any time after the Rights become exercisable, the Rights will entitle the holder to acquire a certain number of shares of common stock of the acquiring company at a substantial discount. The Rights are redeemable by the Company at a redemption price of \$.01 per Right at any time before the Rights become exercisable. The Rights will expire on March 1, 2008, unless previously redeemed.

#### Employee Stock and Incentive Plans

Under the 1994 Equity Compensation Plan ("1994 Plan"), as amended and restated effective March 3, 1998, the Company may grant qualified and non-qualified stock options to officers, key employees and consultants. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors ("Board"). In November 1998, the Shareholders authorized an increase to the number of shares from 1,900,000 shares to 2,900,000 shares of common stock for issuance under the 1994 Plan. The maximum number of shares that may be subject to grants under the 1994 Plan to any one individual in any one year is 100,000. Awards under this plan are made by the Board of Directors or a committee of the Board.

Options under the 1994 plan, as well as the earlier 1988 Stock Option Plan were issued at the market price of the stock on the day of the grant. Options are exercisable in installments ranging from 20% to 50% annually, starting one year from the date of the grant and expire either 5 or 10 years from the date of the grant.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The following table summarizes stock option transactions for the two plans:

	As of or For the Years Ended December 31,					
	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options:						
Outstanding, beginning of year	1,133,907	\$ 13.75	1,107,614	\$ 11.03	1,202,541	\$ 9.53
Granted	302,500	21.43	263,500	22.13	263,333	15.14
Terminated	(7,557)	20.50	(36,710)	12.54	(62,904)	11.43
Exercised	(145,526)	11.17	(200,497)	9.94	(295,356)	8.48
Outstanding, end of year	<u>1,283,324</u>	<u>\$ 15.81</u>	<u>1,133,907</u>	<u>\$ 13.75</u>	<u>1,107,614</u>	<u>\$ 11.03</u>
Exercisable, end of year	<u>724,832</u>	<u>\$ 12.05</u>	<u>607,535</u>	<u>\$ 10.04</u>	<u>547,858</u>	<u>\$ 9.44</u>

Options exercised during 1999 ranged in price from \$8.56 per share to \$22.13 per share. At December 31, 1999, 1,299,326 options under the 1994 Plan were still available for grant. The following table summarizes the price ranges of the options outstanding and options exercisable as of December 31, 1999:

	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Range of prices:					
\$ 6.59 - 11.99	480,390	4.6	\$ 9.33	480,390	\$ 9.33
\$12.00 -16.99	244,938	6.9	14.97	159,946	14.89
\$17.00 -22.13	557,996	8.7	21.75	84,496	22.13
	<u>1,283,324</u>	<u>6.8</u>	<u>\$ 15.81</u>	<u>724,832</u>	<u>\$ 12.05</u>

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

Under SFAS No. 123, "Accounting for Stock-Based Compensation", the Company elects to continue to apply the provisions of APB Opinion No. 25 and to provide the pro forma disclosure provisions of this statement. Accordingly, no compensation cost has been recognized in the financial statements for stock options that have been granted. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net income available to common stock and Basic and Diluted net income per share would have been reduced to the pro forma amounts indicated below:

	Years Ended December 31,		
	1999	1998	1997
Net income available to common stock:			
As reported	\$ 36,275	\$ 44,820	\$ 32,278
Proforma	35,398	44,277	31,989
Basic net income per share:			
As reported	\$ 0.89	\$ 1.11	\$ 0.84
Proforma	0.87	1.10	0.83
Diluted net income per share:			
As reported	\$ 0.88	\$ 1.10	\$ 0.83
Proforma	0.86	1.08	0.82

The per share weighted-average fair value at the date of grant for stock options granted during 1999, 1998 and 1997 was \$5.35, \$5.32, and \$2.90 per option, respectively. The fair value of options at the date of grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	1999	1998	1997
Expected life (years)	10	10	10
Interest rate	5.4%	5.6%	6.6%
Volatility	20.9%	16.9%	13.8%
Dividend yield	3.2%	2.9%	4.0%

Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. During 1999, 1998 and 1997, 4,400, 23,600 and 3,600 shares of restricted stock were granted with a restriction period ranging from six to 36 months. The value of restricted stock awards, which are "compensatory", is equal to the fair market value of the stock on the date of the grant less payments made by the grantee and is amortized ratably over the restriction period.

### Pension Plans and Other Postretirement Benefits

The Company has defined benefit pension plans that cover its full-time employees. Retirement benefits under the plans are generally based on the employee's total years of service and compensation during the last five years of employment. The Company's policy is to fund these plans annually at a level which is deductible for income tax purposes and which provides assets sufficient to meet its pension obligations. To offset certain limitations imposed by the Internal Revenue Code with respect to payments under qualified plans, the Company has a non-qualified Excess Benefit Plan for Salaried Employees in order to prevent certain employees from being penalized by these limitations. The Company also has non-qualified Supplemental Executive Retirement Plans for current and retired employees. The net pension costs and obligations of the qualified and non-qualified plans are included in the tables which follow.

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

In addition to providing pension benefits, the Company offers certain Postretirement Benefits other than Pensions ("PBOPs") to employees retiring with a minimum level of service. These PBOPs include continuation of medical and prescription drug benefits for all eligible retirees and a life insurance policy for eligible union retirees. The Company funds its gross PBOP cost through various trust accounts.

The Company's pension expense includes the following components:

	Years Ended December 31,		
	1999	1998	1997
Benefits earned during the year	\$ 3,232	\$ 2,949	\$ 2,522
Interest cost on projected benefit obligation	7,214	6,771	6,327
Expected return on plan assets	(10,304)	(9,049)	(7,859)
Net amortization and deferral	(105)	(38)	(2)
Capitalized costs	(47)	(48)	(113)
Rate-regulated adjustment	430	(134)	(552)
Special termination benefits	716	56	-
Net pension cost	<u>\$ 1,136</u>	<u>\$ 507</u>	<u>\$ 323</u>

The rate-regulated adjustment set forth above is required in order to reflect pension expense for the Company in accordance with the method used in establishing water rates. During 1999 and 1998, the Company instituted early retirement and restructuring programs. These actions resulted in additional termination benefits of \$716 in 1999 and \$56 in 1998.

The Company's costs for postretirement benefits other than pensions includes the following components:

	Years Ended December 31,		
	1999	1998	1997
Benefits earned during the year	\$ 645	\$ 575	\$ 485
Interest cost	1,249	1,229	1,173
Expected return on plan assets	(699)	(475)	(272)
Net amortization and deferral	628	643	638
Special termination benefits	209	-	-
Amortization of regulatory asset	208	257	161
Gross PBOP cost	<u>2,240</u>	<u>2,229</u>	<u>2,185</u>
Capitalized costs	(464)	(454)	(435)
Net PBOP cost	<u>\$ 1,776</u>	<u>\$ 1,775</u>	<u>\$ 1,750</u>

# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The changes in the benefit obligation and fair value of plan assets, the funded status of the plans and the assumptions used in the measurement of the company's benefit obligation are as follows:

	Pension Benefits		Other Postretirement Benefits	
	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at January 1,	\$ 106,047	\$ 93,373	\$ 19,015	\$ 16,207
Service cost	3,123	2,949	649	575
Interest cost	7,202	6,771	1,252	1,229
Plan amendments	-	804	-	928
Special termination benefits	689	56	28	-
Change in measurement date	2,024	-	181	-
Actuarial loss (gain)	(15,747)	6,843	(3,258)	612
Benefits paid	(5,110)	(4,749)	(575)	(536)
Benefit obligation at December 31,	<u>98,228</u>	<u>106,047</u>	<u>17,292</u>	<u>19,015</u>
Change in plan assets:				
Fair value of plan assets at January 1,	116,848	102,773	8,003	5,437
Actual return on plan assets	13,455	18,715	1,196	1,077
Employer contributions	39	109	2,162	2,025
Change in measurement date	3,135	-	311	-
Benefits paid	(5,110)	(4,749)	(575)	(536)
Fair value of plan assets at December 31,	<u>128,367</u>	<u>116,848</u>	<u>11,097</u>	<u>8,003</u>
Funded status of plan:				
Funded status at December 31,	(30,139)	(10,801)	6,195	11,012
Contributions for fourth quarter	-	-	-	(357)
Unrecognized actuarial gain	37,755	18,306	8,508	5,025
Unrecognized prior service cost	(3,443)	(3,874)	819	876
Rate-regulated adjustment	(1,366)	(1,803)	-	-
Unrecognized net transition obligation	1,876	1,967	(11,750)	(12,654)
Accrued benefit costs	<u>\$ 4,683</u>	<u>\$ 3,795</u>	<u>\$ 3,772</u>	<u>\$ 3,902</u>
Weighted-average assumptions as of December 31,				
Discount rate	7.75%	6.75-7.00%	7.75%	6.75-7.00%
Expected return on plan assets	9.00%	9.00%	6.00-9.00%	6.00-9.00%
Rate of compensation increase	4.50-5.50%	4.50-5.50%	4.50%	4.50%

The CWC plans were measured as of September 30, 1998 in the above table. This change in accounting method establishes December 31 as the measurement date for all PSC plans and does not result in a material impact to the plan assets or benefit obligation.

## PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The accumulated benefit obligation is in excess of plan assets for certain non-qualified plans. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for these plans were \$2,886, \$1,898 and \$0, and \$3,685, \$1,758 and \$0, respectively as of December 31, 1999 and 1998.

The assumed medical inflation rates under the PSC plans are 6.0%, reducing to 4.5% in 2002 for retirees under the age of 65 and 15.0%, reducing to 4.5% by 2006 for retirees 65 years of age and over. The assumed medical inflation rates under the CWC plans are 5.5%, reducing by 0.5% annually until 2001 and remain at 5.0% thereafter. The effect of a 1% increase in the assumed medical inflation rates would be to increase the accumulated postretirement benefit obligation as of December 31, 1999 and the 1999 PBOP costs by \$1,030 and \$114, respectively. The effect of a 1% decrease in the assumed medical inflation rates would be to decrease the accumulated postretirement benefit obligation as of December 31, 1999 and the 1999 PBOP costs by \$1,640 and \$236, respectively. The benefits of retired officers and certain other retirees are paid by the Company and not from plan assets due to limitations imposed by the Internal Revenue Code.

#### Water Rates

In October 1999, PSW, in conjunction with CWC's Pennsylvania subsidiaries, filed an application with the Pennsylvania Public Utility Commission ("PAPUC") requesting a \$28,000 or 15.5% increase in annual revenues. The application is currently pending before the PAPUC and a final determination is anticipated by July 2000. In October 1997, the PAPUC approved a rate settlement reached between PSW and the parties actively litigating the rate application PSW filed in April 1997. The settlement was designed to increase PSW's annual revenue by \$9,300 or 7.3% over the level in effect at the time of the filing. The rates in effect at the time of the filing included a 1% or \$1,300 Distribution System Improvement Charge ("DSIC"). Consequently, the settlement resulted in a total base rate increase of \$10,600 or 8.3%.

The CWC operating subsidiaries were allowed annual rate increases of \$390 for 1999, \$3,334 for 1998 and \$2,769 for 1997, represented by two, five, and four rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately \$308, \$1,969, and \$489 in 1999, 1998 and 1997, respectively.

The DSIC enables water utilities in Pennsylvania to add a surcharge to customer bills reflecting the capital costs and depreciation related to certain distribution system improvement projects completed and placed into service between base rate filings. PSW is permitted to request adjustments to the DSIC quarterly to reflect subsequent capital expenditures and it is reset to zero when new base rates that reflect the costs of those additions become effective or when PSW's pro forma earnings exceed a PUC benchmark. The maximum DSIC that can be in effect at any time is 5%. The DSIC in the first quarter of 2000 has been set at 5% and is expected to continue at 5% until new base rates become effective. The DSIC provided revenues in 1999, 1998 and 1997 of \$4,140, \$229 and \$1,104, respectively.

In addition to its base rates and DSIC, PSW and CWC's Pennsylvania subsidiaries have utilized a surcharge or credit on their bills to reflect certain changes in Pennsylvania State taxes until such time as the tax changes are incorporated into base rates. Various surcharge rates provided operating revenues of \$1,306 in 1999, and rate credits reduced operating revenues in 1998 by \$117. There were no surcharges or credits during 1997.



# PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

### Discontinued Operations

The net reserve of discontinued operations is comprised of two separate operations as follows:

	December 31,	
	1999	1998
Net reserve (assets) of CWC's CAT operations	\$ 113	\$ (418)
Net reserve of PSC's nonregulated businesses	1,008	1,008
Net reserve of discontinued operations	<u>\$ 1,121</u>	<u>\$ 590</u>

In April 1997, the Board of Directors of CWC announced its intention to dispose of its technical services company, Consumers Applied Technologies, Inc. ("CAT"). A reserve for estimated losses and certain future costs was established in 1997 of \$2,350, net of tax benefits of \$1,211. CWC had been unable to sell CAT as an on-going business and is proceeding with its liquidation. CAT's operations were substantially shutdown during 1997. The operating results of CAT prior to the date of discontinuance are shown under discontinued operations on the accompanying consolidated statements of income and comprehensive income. Operating revenues for the discontinued operations for 1998 and 1997 were \$393 and \$4,573, respectively. The net reserve (or assets) of CWC's discontinued operations consist primarily of the reserve for estimated future costs associated with CAT, less accounts receivable. The change in the net reserve during 1999 was due to the collections of accounts receivable from former customers.

The Board of Directors of PSC had authorized the sale of substantially all of the Company's non-regulated businesses and the last of these businesses was sold in 1993. At the time the Board of Directors of PSC authorized the sale of these businesses, the Company established reserves for estimated losses and certain future costs. These reserves were recorded on the balance sheet net of related income tax benefits. Management continues to assess the asserted and unasserted legal claims related to these discontinued operations, and the reserves will be adjusted when certain contingencies are reduced or an assessment indicates that a reserve is no longer necessary.

Selected Quarterly Financial Data (Unaudited)  
(in thousands of dollars, except per share amounts)

Philadelphia Suburban Corporation and Subsidiaries

	First	Second	Third	Fourth	Total Year
1999					
Operating revenues	\$ 58,597	\$ 66,165	\$ 69,527	\$ 63,037	\$ 257,326
Operations and maintenance expense	22,725	24,203	24,645	27,185	98,758
Net income available to common stock	316	12,033	14,332	9,594	36,275
Basic net income per common share	0.01	0.29	0.35	0.24	0.89
Diluted net income per common share	0.01	0.29	0.35	0.23	0.88
Dividends declared and paid per common share	0.17	0.17	0.18	0.18	0.70
Price range of common stock					
- high	29.75	25.75	25.31	24.19	29.75
- low	19.75	21.31	21.13	20.19	19.75
1998					
Operating revenues	\$ 57,933	\$ 61,740	\$ 68,991	\$ 62,107	\$ 250,771
Operations and maintenance expense	23,604	24,005	25,216	27,314	100,139
Net income available to common stock	7,852	14,577	13,787	8,604	44,820
Basic net income per common share	0.20	0.36	0.34	0.21	1.11
Diluted net income per common share	0.19	0.36	0.34	0.21	1.10
Dividend paid per common share	0.1625	0.1625	0.1700	0.1700	0.6650
Dividend declared per common share	-	0.1625	0.1700	0.1700	0.5025
Price range of common stock					
- high	25.75	22.56	28.19	30.06	30.06
- low	19.56	18.88	20.50	23.00	18.88

High and low prices of the Company's common stock are as reported on the New York Stock Exchange Composite Tape.

Dividends paid and declared per common share represents PSC's historical dividends. The cash dividend paid in March 1998 of \$0.1625 was declared in December 1997.

Net income available to common stock and net income per common share for the first quarter of 1999 includes net charges of \$6,134 (\$6,334 pre-tax), or \$0.15 per share, for the Consumers Water Company merger transaction costs and a charge for related restructuring costs of \$2,462 (\$3,787 pre-tax), or \$0.06 per share.

Net income available to common stock and net income per common share for the second quarter of 1998 includes a net gain of \$3,903 (\$6,680 pre-tax), or \$0.10 per share, on the sale of Consumers Water Company's New Hampshire system pursuant to the State's condemnation statute.

Summary of Selected Financial Data  
(in thousands of dollars, except per share amounts)

Philadelphia Suburban Corporation and Subsidiaries

Years ended December 31,	1999	1998	1997	1996	1995
<b>PER COMMON SHARE:</b>					
Income from continuing operations (a)					
Basic	\$0.89	\$1.11	\$0.91	\$0.78	\$0.83
Diluted	0.88	1.10	0.90	0.77	0.83
Net income (a)					
Basic	0.89	1.11	0.84	0.72	0.83
Diluted	0.88	1.10	0.83	0.71	0.82
Cash dividends paid (b)	0.70	0.67	0.62	0.59	0.57
Cash dividends declared (b) (c)	0.70	0.50	0.79	0.59	0.57
Return on average stockholders' equity (a) (d)	10.1%	13.6%	11.8%	10.5%	11.6%
Book value at year end	\$8.89	\$8.53	\$7.70	\$7.44	\$7.21
Market value at year end	20.69	29.56	22.08	14.91	10.38
<b>INCOME STATEMENT HIGHLIGHTS:</b>					
Operating revenues (d)	\$257,326	\$250,771	\$235,852	\$215,971	\$208,100
Depreciation and amortization (d)	31,903	29,464	27,977	25,277	21,825
Interest expense (d) (e)	31,796	30,785	32,317	29,112	27,492
Income before income taxes (d)	62,915	75,133	57,642	48,554	49,673
Provision for income taxes (d)	26,531	30,118	22,432	19,350	19,786
Income from continuing operations (a)	36,384	45,015	35,210	29,204	29,887
Net income available to common stock (a)	36,275	44,820	32,278	26,918	29,647
<b>BALANCE SHEET HIGHLIGHTS:</b>					
Total assets	\$1,280,805	\$1,156,733	\$1,083,162	\$1,038,926	\$948,039
Property, plant and equipment, net	1,135,364	1,016,194	952,626	907,739	817,374
Stockholders' equity	368,901	353,088	306,816	289,436	266,399
Preferred stock with mandatory redemption (f)	-	-	4,214	5,643	7,143
Long-term debt (f)	425,946	377,355	407,526	403,524	351,853
Total debt	529,015	440,905	436,756	426,438	368,939
<b>ADDITIONAL INFORMATION:</b>					
Net cash flows from operating activities	\$74,103	\$84,362	\$71,252	\$56,274	\$53,217
Capital additions (d) (g)	96,383	87,973	67,378	66,130	73,369
Dividends on common stock	29,217	29,349	26,752	25,137	23,452
Number of metered customers	548,937	525,959	519,160	512,150	487,730
Number of shareholders of common stock	21,187	20,553	19,902	19,905	18,514
Common shares outstanding (000)	41,013	40,702	39,112	38,162	36,602
Employees (full-time)	945	973	979	1,016	1,027

- (a) The 1999 amounts include a net charge of \$8,596 (\$10,121 pre-tax) or \$0.21 per share for the Consumers Water Company merger transaction costs and related restructuring costs. The 1998 amounts include a net gain of \$3,903 (\$6,680 pre-tax) or \$0.10 per share on the sale of Consumers Water Company's New Hampshire system pursuant to the State's condemnation statute.
- (b) Amount represents PSC's historical dividends per common share.
- (c) The cash dividend of \$0.1625, paid in March 1998, was declared in December 1997.
- (d) Continuing operations only.
- (e) Includes dividends on preferred stock of subsidiary and minority interest; net of allowance for funds used during construction.
- (f) Includes current portion.
- (g) Excludes payments for acquired water systems of \$39,164 in 1999, \$24,498 in 1998, \$1,226 in 1997, \$44,110 in 1996, and \$27,651 in 1995.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
INVESTOR AND SHAREHOLDER INFORMATION

Financial Reports and Investor Relations

Shareholders may request, without charge, copies of the company's financial reports including Annual Reports and Forms 10-K and 10-Q. Such requests, as well as other inquiries of an investor relations nature, should be addressed to:

Investor Relations Department  
Philadelphia Suburban Corporation  
762 W. Lancaster Avenue  
Bryn Mawr, PA 19010-3489  
www.suburbanwater.com

Annual Meeting

10:00 a.m. Eastern Daylight Time  
Monday, May 15, 2000  
Springfield Country Club  
400 West Sproul Road  
Springfield, PA

Transfer Agent and Registrar

Bank Boston, N.A.  
c/o EquiServe, L.P.  
P.O. Box 8040  
Boston, MA 02266-8040  
800-205-8314 or 781-575-3100  
www.equiserve.com

Independent Certified Public Accountants

KPMG LLP  
1600 Market Street  
Philadelphia, PA 19103-7212

Stock Exchanges

The Common Stock of the company is listed on the New York Stock Exchange and the Philadelphia Stock Exchange under the ticker symbol "PSC". The daily closing price is printed in *The Wall Street Journal* and other major newspapers, typically as PhlSuburbn.

Dividend Reinvestment and Direct Stock Purchase Plan

The company's Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") enables shareholders to reinvest all, or a designated portion of, dividends paid on up to 40,000 shares of Common Stock in additional shares of Common Stock at a five percent discount from a price based on the market value of the stock with no commissions or service charges. In addition, shareholders may purchase additional shares of PSC Common Stock at any time with a minimum investment of \$50, up to a maximum of \$30,000 annually. PSC pays the commissions and fees on purchases. Individuals who are not shareholders may become shareholders by making an initial investment of at least \$500. A Plan prospectus may be obtained by calling 800-205-8314. Please read the prospectus carefully before you invest. Shares for the direct stock purchase portion of the Plan are purchased in the open market at prevailing market prices, with no commissions or other fees.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
INVESTOR AND SHAREHOLDER INFORMATION

IRA, Roth IRA, Education IRA

An IRA, Roth IRA or Education IRA may be opened through the Plan to hold shares of Common Stock of the company and to make contributions to the IRA to purchase shares of Common Stock. Participants in the Plan may roll over an existing IRA or other qualified plan distribution in cash into an IRA under the Plan to purchase the company's common stock. Participants may also transfer the company's Common Stock from an existing IRA into an IRA under the Plan. Purchases of shares through the IRA are made without any fees, commissions, or service charges. A prospectus, IRA forms and a disclosure statement may be obtained by calling 800-472-7428. Please read the prospectus carefully before you invest.

Direct Deposit

With direct deposit, PSC cash dividends are deposited automatically on the dividend payment date of each quarter. Shareholders receive confirmation of the deposit in the mail. Shareholders interested in direct deposit should call the transfer agent at 800-205-8314.

Multiple Accounts

Some shareholders have multiple accounts. The transfer agent cannot change or merge accounts without your written request. If you would like to help us avoid the expense of multiple mailings, call the transfer agent at 800-205-8314 to get details on how to have your accounts consolidated.

Dividends

PSC has paid dividends consecutively for 55 years. The normal Common Stock dividend dates through June 2001 are:

<u>Declaration Date</u>	<u>Ex-Dividend Date</u>	<u>Record Date</u>	<u>Payment Date</u>
February 1, 2000	February 10, 2000	February 15, 2000	March 1, 2000
May 1, 2000	May 10, 2000	May 15, 2000	June 1, 2000
August 1, 2000	August 10, 2000	August 15, 2000	September 1, 2000
November 1, 2000	November 10, 2000	November 15, 2000	December 1, 2000
January 30, 2001	February 8, 2001	February 13, 2001	March 1, 2001
May 1, 2001	May 10, 2001	May 15, 2001	June 1, 2001

In order to be the owner of record and be eligible to receive the quarterly dividend, shares must have been purchased and the transaction settled before the ex-dividend date. Owners of any share(s) bought after this date will not receive the dividend for that quarter. The previous owner—the owner of record—will receive the dividend.

Only the Board of Directors may declare dividends and set record dates. Therefore, these dates may change at the discretion of the Board. Announcement of the dividend declaration is usually published in *The Wall Street Journal* and several local newspapers.

Dividends paid on the company's Common Stock are subject to Federal and State income tax.

PHILADELPHIA SUBURBAN CORPORATION AND SUBSIDIARIES  
INVESTOR AND SHAREHOLDER INFORMATION

Lost Dividend Checks and Stock Certificates

Dividend checks lost by shareholders, or those that might be lost in the mail, will be replaced upon notification of the lost or missing check. All inquiries concerning lost or missing dividend checks should be made to the transfer agent by calling 800-205-8314.

Shareholders should call or write the transfer agent to report a lost certificate. Appropriate documents will be prepared and sent to the shareholder together with instructions.

Safekeeping of Stock Certificates

Shareholders may have their stock certificate deposited with the transfer agent for safekeeping free of charge. Stock certificates and written instructions should be forwarded to:

Bank Boston, N.A.  
c/o EquiServe, L.P.  
Attn: DRP Department  
P.O.Box 8040  
Boston, MA 02266-8040